

Message Text

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ACTION EB-08

INFO OCT-01 EUR-12 IO-13 ISO-00 SP-02 USIA-06 AID-05
NSC-05 SS-15 STR-04 OMB-01 CEA-01 L-03 H-01 PA-01
PRS-01 CIAE-00 FRB-03 INR-07 NSAE-00 XMB-02
OPIC-03 LAB-04 SIL-01 AGRE-00 /099 W
-----211750Z 026507 /53

R 211709Z MAR 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 1781
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
AMEMBASSY PARIS
AMEMBASSY ROME
AMCONSUL BELFAST
AMCONSUL EDINBURGH
USMISSION EC BRUSSELS
USMISSION OECD PARIS
USDEL MTN GENEVA
USDOC WASHDC

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DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A
TAGS: ECON, U,
SUBJECT: RENEWAL OF PRICE CONTROLS -. THE ANNUAL TUQ OF
WAR

REF: (A) LONDON 10394,7/2/76; (B) LONDON 3746

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SUMMARY: THE ANNUAL TUG OF WAR OVERRENEWAL OF THE PRICE
CODE IS PARTICULARLY BITTER THIS YEAR. INDUSTRY HAD BEEN
ANTICIPATING AN END TO PRICE CONTROLS. HOWEVER, IN THE
WAKE OF A RECENT SURGE IN THE RATE OF INFLATION, ORGAN-
IZED LABOR STRONGLY ADVOCATED MORE STRINGENT CONTROLS.
UNDER THESE CIRCUMSTANCES, THE GOVERNMENT FELT CON-
STRAINED TO RETAIN THE PRICE CODE. PROPOSING A SET OF RE-

VISIONS SATISFYING NEITHER LABOR NOR INDUSTRY ON A PERMANENT BASIS BUT GENERATING PARTICULAR IRE FROM RETAILERS AND DISTRIBUTORS. BARRING A CHANGE IN GOVERNMENT, THE REVISED CODE IS LIKELY TO BE ADOPTED LARGELY INTACT WITH INDUSTRY OPERATING UNDER CONSIDERABLE UNCERTAINTY UNTIL EXPERIENCE REVEALS HOW HMG INTERPRETS ITS BROADENED AUTHORITY. END SUMMARY.

1. INTRODUCED DURING THE FINAL YEAR OF THE HEATH GOVERNMENT, PRICE CONTROLS HAD BEEN INTENDED AS A TEMPORARY MEASURE DESIGNED TO EXPIRE IN JULY 1976. WITH THE INTRODUCTION OF INCOMES POLICY IN AUGUST 1975, PRICE CONTROLS BECAME ENMESHED IN THE SOCIAL CONTRACT AS ORGANIZED LABOR INSISTED ON THEM AS PART OF THE WAGE RESTRAINT BARGAIN. THUS, THE PRICE CODE WAS REVISED AND EXTENDED FOR A THIRD YEAR (TO MID-1977) WHEN THE ORIGINAL LEGISLATIVE AUTHORITY EXPIRED LAST JULY. THEORETICALLY, THE REVISIONS PERMITTED JUST ENOUGH LIBERALIZATION TO ADD ABOUT 1 PERCENT TO RETAIL PRICES OVER THE 12 MONTHS THROUGH JULY 1977. WHEN THESE REVISIONS WERE ANNOUNCED (REF A) IT WAS FULLY ANTICIPATED BY HMG THAT RETAIL PRICES AND INFLATION WOULD BE APPROACHING SINGLE DIGITS BY THE END OF 1976 WITH SINGLE DIGIT INFLATION A VIRTUAL CERTAINTY BY MID-1977. UNDER THESE CIRCUMSTANCES INDUSTRY BELIEVED IT PROBABLE THAT THE JULY 31, 1977 EXPIRATION DATE OF THE PRICE CODE WOULD PASS WITH NO FURTHER EXTENSION OF PRICE CONTROLS.

2. IN THE EVENT, A DRAMATIC DECLINE IN STERLING COUPLED LIMITED OFFICIAL USE

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WITH THE CONTINUING ADJUSTMENT OF U.K. FOOD PRICES TO EC LEVELS AND SHARP INCREASES IN UTILITY AND TRANSPORT PRICES ALL CONTRIBUTED TO A REACCELERATION OF INFLATION DURING THE SECOND HALF OF 1976. INCREASINGLY WORRIED BY THIS TREND, MAJOR UNION LEADERS, JACK JONES IN PARTICULAR, BEGAN TO PRESS FOR STRICTER PRICE CONTROLS WITH JONES RECENTLY GOING AS FAR AS TO CALL FOR A FREEZE ON CERTAIN PRICES. (REF B) UNDER MOUNTING TRADE UNION PRESSURE, IT WAS CLEAR THAT HMG WAS IN NO POSITION TO ALLOW PRICE CONTROLS TO EXPIRE IF THERE WERE TO BE ANY HOPE OF OBTAINING A THIRD YEAR OF WAGE RESTRAINT.

3. THIS WAS THE BACKGROUND AGAINST WHICH HMG INTRODUCED ITS FEBRUARY 23 PROPOSALS TO MAKE PRICE CONTROLS A PERMANENT FEATURE OF THE BRITISH ECONOMIC SCENE.

CURRENTLY, THE PRICE CONTROL MECHANISM RELIES ON TWO SEPARATE ELEMENTS:

- COST CONTROLS;
- MAXIMUM ALLOWABLE PROFIT MARGINS.

THE PRICE CODE CONTAINS RULES SETTING OUT THE KINDS OF
COST INCREASES WHICH MAY BE REFLECTED IN HIGHER PRICES
IN ADDITION, SHOULD A FIRM EXCEED ITS BASE PERIOD (1973)
PROFIT MARGIN, IT MUST REDUCE PRICES SO AS TO NARROW ITS
PROFIT MARGIN TO THE ALLOWABLE LEVEL. THE ACTUAL CODE
IS FAR MORE COMPLEX CONTAINING DIFFERENT KINDS OF WAIVERS
TO ENCOURAGE GREATER INVESTMENT AND MORE EFFICIENT USE OF

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EXISTING RESOURCES, TOGETHER WITH PROCEDURES REQUIRING
LARGE FIRMS TO GIVE 4 WEEKS' NOTICE OF THEIR INTENT TO
RAISE PRICES.

4 SINCE THE CODE WAS INTRODUCED, FEW FIRMS HAVE OPER-

ATED AT OR ABOVE THEIR ALLOWABLE PROFIT MARGINS. THE
DEPRESSED LEVEL OF AGGREGATE DEMAND STIMULATED INCREASED
COMPETITION AMONG FIRMS LEADING TO A CONTRACTION OF PROF-
IT MARGINS TO JUST UNDER 50 PERCENT OF THE LEVELS CHAR-
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ACTERISTIC OF THE BASE PERIOD. THE DAY.TO.DAY OPERATION
OF THE CODE CENTERED LARGELY ON THE NATURE OF ALLOWABLE
COST INCREASES WHICH COULD BE PASSED ON IN THE FORM OF
HIGHER PRICES. AS A RESULT. NEARLY ALL REQUESTS FOR
PRICE INCREASES WERE APPROVED. THUS, AFTER THREE YEARS
OF EXPOSURE TO THE CURRENT RULES FIRMS GENERALLY KNEW
WHERE THEY STOOD IF THEY INTENDED TO INCREASE PRICES.
THE PROPOSED REVISIONS END THAT CERTAINTY.

5. THE NEW CODE. BY VIRTUALLY ELIMINATING THE RULES ON
ALLOWABLE COSTS. WILL SHIFT THE EMPHASIS TO THE CONTROL
OF PROFIT MARGINS. AT FIRST BLUSH THIS WOULD APPEAR TO
SIMPLIFY MATTERS GREATLY SINCE FIRMS WOULD NO LONGER
BE SUBJECT TO THE COMPLEX RULES DEFINING ALLOWABLE COSTS.
HOWEVER' THE GOVERNMENT PROPOSED TO REPLACE THE OLD RULES
BY GIVING THE PRICE COMMISSION ENLARGED POWERS OF INVESTI
GATION. THESE POWERS WILL ALLOW THE COMMISSION TO IN-
VESTIGATE VIRTUALLY ANY PRICE INCREASE INITIATED BY ANY
FIRM. THE FIRM BEING INVESTIGATED WOULD HAVE TO FREEZE
THE PRICE OF THE ITEM IN QUESTION FOR A PERIOD OF 3
MONTHS WHILE THE COMMISSION UNDERTOOK AN INVESTIGATION
OF THE PROPOSED INCREASE. ACCORDING TO THE PROPOSED RE-
VISIONS THE INVESTIGATION "WOULD TAKE ACCOUNT OF THE
PARTICULAR CONDITIONS IN THE ENTERPRISE; (IT) WOULD NOT.
AS IN THE (PRESENT) CODE, REGARD COST INCREASES AS IN-
EVITABLE BUT COULD GO INTO THE REASONS FOR (AND AGAINST)
THEM; AND THIRD PARTIES WOULD BE ABLE TO PUT THEIR VIEWS
TO THE COMMISSION "

6 THE INTENT OF THE ENLARGED INVESTIGATORY POWERS IS
"TO RELIEVE COMPANIES OF THE RIGIDITIES OF THE PRESENT
COST CONTROLS AND THE ADMINISTRATIVE BURDEN THE LATTER
CREATE. THEY WOULD ESTABLISH A NEW REGIME IN WHICH PRIC.
ING DECISIONS WHICH AFFECT THE WHOLE OF SOCIETY WOULD BE
MADE SOCIALLY ACCOUNTABLE."

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7. FROM THE POINT OF VIEW OF INDUSTRY THESE NEW POWERS
APPEAR VAGUE AND POTENTIALLY CAPRICIOUS. WHILE IT IS

CLEAR THE PRICE COMMISSION COULD UNDERTAKE ONLY A VERY LIMITED NUMBER OF INVESTIGATIONS (ABOUT 40 A YEAR), THE CRITERIA UPON WHICH COST INCREASES WILL BE DEEMED ALLOWABLE ARE NO LONGER UNIFORM BUT WILL BE TAILORED TO EACH FIRM ON THE BASIS OF SOCIAL ACCOUNTABILITY.

8. FROM THE GOVERNMENT'S STANDPOINT THE PROPOSED REVISIONS ARE RESPONSIVE TO INDUSTRY'S COMPLAINTS ABOUT THE RIGIDITIES OF THE PRESENT RULES. HOWEVER, THE ENLARGED INVESTIGATIVE POWERS ARE THERE TO PREVENT INDUSTRY FROM CONTEMPLATING ROOT AND BRANCH PRICE INCREASES WHEN THE CURRENT CODE EXPIRES. FINALLY, FROM ORGANIZED LABOR'S POINT OF VIEW THE PHYSICAL LIMITATIONS ON THE NUMBER OF INVESTIGATIONS RAISES THE FEAR OF RAMPANT PRICE INCREASES AND DOES LITTLE TO RESPOND TO UNION LEADERS' CALLS FOR LIMITED PRICE FREEZES.

9. COMMENT THE BATTLE OVER PRICE CONTROLS IS PART OF THE LARGER WAR BEING WAGED BY HMG'S ECONOMIC MANAGERS. IN ECONOMIC TERMS, IT IS HARD TO POINT TO ANY BENEFITS DIRECTLY ATTRIBUTABLE TO THE EXISTENCE OF PRICE CONTROLS. THAT THIS WILL CONTINUE TO BE TRUE IS VIRTUALLY BEYOND DEBATE. BRITAIN'S 125 PERCENT INCREASE IN RETAIL PRICES SINCE 1970 STEMS FROM A VARIETY OF CAUSES BUT EXCESSIVE PROFIT MARGINS IS NOT ONE OF THEM. PRICE CONTROLS EXIST PRIMARILY FOR POLITICAL REASONS. IN THE CURRENT PHASE, THEY ARE AN INDISPENSABLE QUID PRO QUO FOR ANY AGREEMENT TO A FURTHER PERIOD OF WAGE RESTRAINT BY THE TRADES UNIONS. THE SHRILL PROTESTS FROM INDUSTRY ARE PROBABLY DESIGNED TO EITHER WEAKEN THE PROPOSED PROVISIONS, OR TO ASSURE A NOT-TOO-SEVERE APPLICATION OF THE CODE. THE CURRENT LABOR GOVERNMENT'S INDUSTRIAL CONTROL MEASURES, BE THEY PLANNING AGREEMENTS, THE NATIONAL ENTERPRISE BOARD, NORTH SEA PARTICIPATION AND OIL TAXATION LIMITED OFFICIAL USE

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HAVE BEEN MORE STRINGENT WHEN INITIALLY PROPOSED THAN THEY HAVE TURNED OUT TO BE IN PRACTICE. THE PROPOSED PRICE CODE SEEMS LIKELY TO FOLLOW SUIT. SPIERS

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